Testimony to Committee on the Budget, House of Representitives

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COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES
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Mr. Chairman:

Thank you for the invitation to testify today before this committee on the current state of the U.S. government's budget and on the proposals contained in the Administration's proposed 2005 budget.

Presidents often begin State of the Union messages with some variation on the phrase "The state of the Union is strong." In the same spirit, I shall begin my testimony with the statement "The state of the federal budget is perilously weak and getting weaker. It is on its way to becoming a threat to national economic and political stability." To this I would add that the Administration's proosed 2005 budget would make that situation worse, not better.

I understand that these are strong words and that not all respected economists would agree with them. I also realize that disagreement among supposed experts puts those who depend on expert testimony in a difficult situation. When experts disagree, why not just wait and see if time clarifies matters? Mr. Chairman, you and your colleagues do not have that luxury. You are in the position of a jury judging a difficult case of transcendent importance. You will hear the evidence, and you must reach a verdict, a verdict of action.

In my testimony, I shall try to make the following points.

! *The deficit in calendar year 2004 is large, but not unprecedented for a recession year. It is not a serious problem and should absorb little of your attention.* Indeed, any belated effort to reduce this year's deficit is neither likely to succeed nor desirable to undertake, as it could hinder recovery from the recession.

! *The deficit projection over the next ten years is distressingly bad. Official statistics do not come close to representing how bad it is for two reasons*:

P official projections are based on conventions that everyone understands to be misleading;

P those projections focus on the unified budget, which misrepresents the long-term implications of current budget policy.

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1 The views expressed in this testimony are my own and do not necessarily represent those of the trustees, officers, or staff of the Brookings Institution

- *The budget situation has deteriorated catastrophically over the past three years*. Events beyond the control of economic policy makers account for much of this deterioration, ***but persistently bad fiscal policy has aggravated the damage from these unfortunate external events***.

- *Although budget prospects for the next decade are bad, they become far worse in later years as retiring baby-boomers push up pension and health outlays*.

- The time to begin repairing the fiscal damage inflicted on our economy is now. For economic reasons *a program of fiscal rehabilitation should—and for political reasons—must, include both spending cuts and tax increases*. The mix will depend on the priorities of the American public, but *no responsible cure for America's fiscal problems can exclude sizeable tax increases*.

- *The program outlined in the Administration's 2005 budget fails distressingly to meet the challenge*. Rather than calling for needed tax increases, it calls for still more tax cuts. It focuses on the wrong target, the unified deficit, which badly understates the size of the deficit problem the nation confronts. Simply maintaining current services would reduce spending more than the Administration's budget would do. Furthermore, spending will almost certainly be higher and tax collections lower than stated in the budget if Administration policies are adopted.

- *The changes in budget procedure that the Administration proposes to control deficits would constrain nondefense spending increases, which account for little of the deficit problem over the next decade, and do nothing to forestall cuts in revenues, erosion of which accounts for most of the problem.*

I. THE CURRENT DEFICIT IS NOT A PROBLEM

The Congressional Budget Office estimates that the unified budget deficit for fiscal year 2004 will total $477 billion, somewhat below the Administration's estimate of $521 billion. This number is misleadingly small because it includes as revenues available to cover current spending $170 billion in revenues counted as additions to Social Security and Medicare Hospital Insurance Trust Fund reserves. All of these cash flow surpluses—and more besides—will be needed to honor currently promised benefits. A better indicator of the size of this year's fiscal shortfall would exclude these accumulations. *If these trust fund additions are not included, the CBO estimate of the budget deficit balloons to $647 billion and the Administration's deficit is approximately $685 billion*.

These deficits, 5.7 and 6.0 percent of projected GDP, respectively, are about as large as were the unified budget deficits in the 1980s, when Social Security and Medicare cash flows were about in balance. Pointing to the unified deficit, some people pooh-pooh this year's deficit as much smaller than those from which the nation suffered during the 1980s. Those claims are misleading because they disregard the fact that the nation was in the 1980s suffering from a much more serious and persistent recession and because they treat funds that are being collected and will be needed to meet future obligations as available for current use.

That said, this year's deficit is not a major concern. Revenues fall during recession, and the recession is not yet clearly over. The very fast growth during the third quarter and the slower, but still encouraging, growth during the fourth quarter of 2003 have not sufficed to produce job growth. The small drop in the unemployment rate is due more to discouraged workers giving up and leaving the labor force than to job creation. Workers continue to exhaust unemployment benefits at record and increasing rates. And auguries for the sustainability of the current recovery remain mixed. In this situation fiscal managers, in my view, should follow a strategy similar to that announced by the Federal Reserve's Open-market Committee of continuing to allow highly stimulative policies to remain in effect until the recovery is undeniably under way.

Current policy remains flawed. The stimulative tax cuts of the past three years could have been designed far more effectively to combat the recession. Reductions in dividend taxes, in capital gains rates, and in marginal tax rates applicable to high-income recipients, who spend a relatively small fraction of their incomes, do far less to stimulate the economy than would tax cuts of equal size directed to recipients of low and moderate incomes, who spend virtually all of their incomes on current consumption. But that legislation is on the books, and Congress should, in my view, look ahead, not back. As I shall argue presently, most attention should be devoted to the long-term budget situation. *But in looking ahead, Congress should not leave unattended two urgent near-term problems*.

The first is the plight of the unemployed who are exhausting their benefits at record levels—an estimated 2 million during the first half of 2004—and whose job prospects remain cloudy.[2] The situation is not equally serious everywhere, but the number of unemployed exhausting their benefits is higher than average in every state in the union and higher than it has been for decades in nine states.

- To pick just two states not entirely at random, an estimated seventeen thousand Iowans (the third highest number for any corresponding period in the last twenty-nine years) and nearly 28,000 South Carolinians (the highest number for any corresponding period in the last thirty-two years) will exhaust their benefits.

The second is the fiscal problem confronting state and local governments. Because of a recession states did not cause and cannot fight, state revenue growth has fallen far behind

[2] Isaac Shapiro, "Unmet Need Hits Record Level for the Unemployed," Center on Budget and Policy Priorities," 30 January 2004 [**http://www.cbpp.org/1-29-04ui.htm**].

projections—an estimated $57 billion less in 2005 than if the recession had not occurred.[3] The result has been two years during which balanced-budget requirements have forced large reductions in public services. Additional deficits are projected for 2005 of roughly $40 billion, more than 8 percent of baseline general fund spending.

- *In those same two not-randomly selected states, the projected deficits are 7 percent of general fund spending in Iowa and 6-10 percent in South Carolina*.[4]

Nor is profligate spending the cause of state fiscal problems. Over the decade from 1989 through 1999, real spending by states grew at an annual rate of only 2 percent. From 2002 through 2005 federal policies have imposed net costs on the states collectively of an estimated $165 billion.[5] The states at first tried to maintain public services by running down rainy day funds, then cut spending and raised taxes.

The result has been stark:

— loss of health benefits for more than 1 million low-income people, more than ½ million of whom are children,
— cutbacks in day care that is necessary to make effective the work requirements under TANF,
— cutbacks on funding of primary and secondary education, and
— reductions in support of higher education, resulting in double-digit tuition increases.

Rather than helping the states, however, the Administration's proposed budget would add to their burdens. It reduces the real value of grants to the states by about $3 billion.[6]

Constituents should ask for an explanation from those members of Congress who supported tax cuts for high income families, but who refuse to support extending unemployment benefits for the long-term unemployed or additional fiscal support to enable states to provide health benefits for

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3 Iris Lav, "Federal Policies Contribute to the Severity of the State Fiscal Crisis," Center on Budget and Policy Priorities, 3 December 2003 [**http://www.cbpp.org/10-17-03sfp.htm**].

4 Nicholas Johnson and Bob Zahradnik, "State Budget Deficits Projected for Fiscal Year 2005," Center on Budget and Policy Priorities, 30 January 2004 [**http://www.cbpp.org/10-22-03sfp2.htm**].

5 The burden arises from federal policies that imposed an estimated $185 billion in added costs less roughly $20 billion in fiscal relief. The added costs came from federal tax changes that narrowed state tax bases, restrictions on the taxation of internet sales, an increase in medical costs for dual eligibles, and a series of unfunded mandates. Iris J. Lav, "Federal Policies Contribute to the Severity of the State Fiscal Crisis.".

6 Iris Lav, "Decline in Federal Grants will Put Additional Squeeze on State and Local Budgets," Center on Budget and Policy Priorities, 2 Febraury 2004.

poor children, books for school children, and day care for children of mothers required to work. Even if one rejects any spending that would further increase the deficit, one can still ask *what value system would lead an elected official to put tax cuts that add to the disposable income of the wealthy ahead of grants that would maintain health care for poor children and education for all*—because those are the priorities that policies advocated by this Administration and passed by this Congress have expressed.

II. Official Budget Projections Seriously Understate The Next Decade's Deficits

Between 2005 and 2014, the Congressional Budget Office anticipates cumulative unified budget deficits totaling $1.893 trillion. According to CBO projections, large early deficits give way to a small surplus in 2014.[7] This projection follows well-established conventions and, based upon those conventions, is done with complete professionalism.

The CBO and the corresponding Administration projections of the unified budget deficit are, however, a misleading guide to the fiscal challenges that the nation faces. To base current economic policy on those projections would be a serious error. The problem is that the CBO unified budget projections focus on the wrong target and are based on implausible assumptions.

The Wrong Target. In fiscal year 2005, the CBO's projected unified budget deficit consists of three components:

- a Social Security cash flow *surplus* of $171 billion,
- a Medicare Hospital Insurance cash flow *surplus* of $18 billion, and
- a non-Social-Security-non-Medicare-Hospital-Insurance *deficit* of $551 billion.

Every nickle of the cash flow surpluses in Social Security and Medicare—and much more besides—will be needed to pay for future benefits, as both programs confront projected, long-term deficits. Furthermore, every nickle of the payroll tax collections that make those surpluses possible is justified on the grounds that it will help pay for future benefits. *Excluding those cash flow surpluses in computing the current budget balance of the nation provides a more accurate indicator of the nation's fiscal shortfall than does the unified budget deficit. Using that measure, the CBO's projected cumulative deficit from 2005 through 2014 is not $1.893 trillion, but $4.438 trillion.*

Implausible Conventions. But even that measure is far off any reasonable projection of what is likely to occur, as shown in several papers by my colleagues William Gale and Peter Orszag

[7] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2005-2014*, January 2004, table 1-1. [

(alone and with various co-authors).[8] Because Peter Orszag testified before you yesterday, I shall only summarize the major points.

The official projections of both the Congressional Budget Office and the Office of Management and Budget are based on the following assumptions:

— that expiring tax provisions (including all of those enacted during the last three years with sunset dates) are allowed to expire on schedule,
— that nothing is done to soften the effect of the spreading reach of the alternative minimum tax, and
— that real discretionary spending (defense and nondefense combined) will be unaffected by either population or income growth.

Dropping these assumptions produces disturbingly higher projected deficits:

Concept	Projected Deficit, 2005-2014
Unified Budget	**$1.893 TRILLION**
Excluding Social Security and Medicare	4.438 trillion
Adjusted for expiring tax provisions and AMT adjustment	7.451 trillion
Adjusted to hold real discretionary spending per person constant	8.035 trillion
Adjusted to hold discretionary spending/GDP constant	**9.002 TRILLION**

The starting point for discussions of the nation's fiscal challenge should not be $1.893 trillion, but somewhere between $4.438 and 9.002 trillion. Since the Administration has made clear its desire to make the tax cuts permanent and, presumably, would not want the minimum tax to deny filers the tax cuts that it deems so beneficial, the starting point is well over $7 trillion. If one supposes that spending on national defense will not sink materially and that some increase in real, per capita nondefense discretionary spending will occur, the budget problem is somewhere in the $7–9 trillion range. ***In other words, over the decade from 2005 through 2014, the budget challenge is roughly four times as large as the CBO's projection of the unified budget deficit would suggest. Furthermore, the deficit with these adjustments does not diminish, but increases steadily, approaching $1 trillion in 2014 alone.***

False Hopes. Some observers downplay the significance of prospective budget deficits by claiming that past deficit projections have been widely off the mark and that we can grow our way out of the current mess. This position is dangerously irresponsible.

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8 For their most recent analysis, see William G. Gale and Peter R. Orszag, "The Budget Outlook: Updates and Implications," 29 January 2004 [

That budget projections are unreliable is well established. It was not only the courageous bipartisan deficit reduction programs enacted in 1990 under President George H. W. Bush and a Democratic Congress, in 1993 by President William Clinton and a Democratic Congress, and in 1997 by President William Clinton and a Republican Congress that eliminated the deficits spawned in the late 1970s and early 1980s. The economic boom of the late 1990s and the revenue bonanza it produced did much of the work. Why couldn't we get lucky again?

Well, we could. But three considerations warn that we should not count on it.

- The first is that the *budget projections of the Congressional Budget Office and the Administration already build in faster productivity growth than was assumed or achieved throughout the 1980s and the early and mid 1990s*. These higher productivity assumptions reflect the improved economic performance of the United States since the late 1990s and are fully warranted. Still higher sustained growth is conceivable. Based on historical trends, however, it is unlikely. Furthermore, even if higher growth were realized, the Administration's own calculations, shown on page 194 of the Analytic Perspectives chapter, "Stewardship," indicate that modest increases would not solve the nation's long-term budget problems.

- Second, *the last productivity surprise followed two decades of courageous and far-sighted economic policy*, beginning with The Tax Reform Act of 1986 enacted during the administration of President Reagan, and continuing with the three deficit-reduction packages passed in 1990, 1993, and 1997. *To count on even higher productivity growth than is already built into budget projections following budget policies that studies carried out by the Congressional Budget Office and outside analysts indicate are more likely to lower productivity growth than to raise it, is neither prudent nor responsible*.

- Third, *it is simply irresponsible to count on good luck to bail us out of clearly foreseeable problems*. Yes, productivity growth could be higher than currently assumed. It could equally well be lower. Economists still do not fully understand why productivity collapsed in the 1970s, and they cannot fully explain why it rose in the late 1990s. To blithely invoke a jump in economic productivity as a budget savior when there is no good reason to foresee it is foolhardy.

III. EVENTS AND BAD POLICY HAVE COMBINED TO CREATE THIS FISCAL PROBLEM

When CBO made its ten-year unified budget projection in 2001, covering the period from 2002 through 2011, it foresaw a cumulative surplus of $5.6 trillion. It now foresees a cumulative deficit for the same ten years of $2.9 trillion. <u>*The total budget deterioration is $8.5 trillion*</u>.

Of that deterioration

- 27 percent is attributable to the tax cuts,[9]
- 19 percent to increased spending on defense and homeland security,
- 15 percent to increased spending, and
- 39 percent to changed economic and technical assumptions.

This apportionment of causes of the deficit shows clearly that the recession contributed in a major way to the deterioration of the budget situation, principally because it has led to a huge and still incompletely understood reduction in revenues. The uninvited, but necessary, increases in spending for defense and homeland security also contributed to the budget turn-around. *But the various tax cuts accounted for $2.4 trillion of the red ink and will add far more in the years after 2011 when recession plays no part in projected deficits*.

To argue, as the Administration does, that the budget would be in deficit even if taxes had not been cut, makes no sense, because that is not the issue. The question, rather, is whether, given the difficult hand that economic events and the terrorist threat have dealt us, it makes sense to make an already bad deficit situation worse by cutting the taxes needed to pay for government services Congress has approved.

The answer is that imprudent tax cuts have made a difficult situation worse. This characterization is fair because opponents to the tax cuts specifically warned that the economic weather could deteriorate in the future as it had in the past.[10] Disregarding such warnings, the Administration relentlessly and rashly insisted on cutting taxes and Congress unwisely concurred. We are now reaping the consequences of this improvidence.

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9 That number would be somewhat, but not much, higher if the assumption that all tax cuts sunset was dropped, because most of the sunsets occur in 2010 or later. The fraction of the 2005-2014 deficit attributable to the tax cuts would be higher and that of future deficits would be much higher if they are not assumed to take effect.

10 On 7 March 2001 in testimony before the Senate Finance Committee, I wrote: “More than three-quarters of the surpluses projected by the Administration and CBO do not occur during the current terms of the incumbent president or 94 percent of the members of Congress.

“No responsibly managed business would commit all of the budget surpluses projected for the next decade. To be sure, future surpluses may be larger than the best current guesses of the CBO and the Administration. I certainly hope they are, so that future Congresses will be able to cut taxes even more than the Administration now requests. I also hope that future events do not put unanticipated demands on our public sector. But we cannot be sure.”

I cite this statement not because I am claiming any particular insight, but on the contrary because my comment was typical of those of many witnesses, editorial writers, and doubters among your own ranks regarding the wisdom of cutting reducing taxes permanently by as much as the Administration then requested and Congress eventually enacted.

It is also misleading to argue that the source of budget problems is "out of control" discretionary spending. Between 2000 and 2004, government spending rose by 1.6 percent and revenues fell by 5 percent of gross domestic product, a total swing from surplus to deficit of 6.6 percent of GDP. Of the increase in spending, about three-quarters was for defense and much of the remainder was for homeland defense. Nondefense discretionary spending rose by about 0.4 percent of GDP, thereby accounting for about 6 percent of the deterioration in the budget. Whether those increases were wise or foolish, I leave to others to debate, but anyone who claims that explosive spending growth is the source of our current deficit problem or the one that the nation will face over the next decade should not be taken seriously. The deficit problem, overwhelmingly, is attributable to declining revenues, which have fallen in part because of the recession and in part because of tax cuts that Congress has enacted.

IV. THINGS GET WORSE

As is well known, budget prospects over the next several decades deteriorate dramatically. *CBO projections indicate that Social Security, Medicare, and Medicaid spending as share of gross domestic product will rise by 3 percentage points of GDP between 2010 and 2020 and by an additional 5 percentage points between 2020 and 2040 under current policy, a total of 8 percentage points of GDP over the three decades from 2010 to 2040*.[11]

Despite irresponsible rhetoric to the contrary, it will be impossible to offset this increase solely by program cuts, program redesign, or improved efficiency. As the recently enacted Medicare amendments demonstrate clearly, pressures to liberalize health benefits for the elderly and disabled are strong. And with good reason. Even after the drug benefit is implemented, Medicare will continue to provide far narrower coverage than does the health insurance enjoyed by the majority of the non-elderly. Retrenchments in private retiree health benefits and skyrocketing Medigap premiums, as well as inadequacies in Medicare coverage will sustain pressures to liberalize, not curtail government-sponsored benefits. *It will take great effort and substantially increased cost sharing by upper-income elderly and disabled simply to stay within current frightening projections*.

Some cuts in Social Security benefits are possible and desirable as part of a program to restore long-term financial balance,[12] but total spending is bound to increase as a share of GDP as the baby-boom retires.

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[11] Henry J. Aaron and Peter R. Orszag, "The Impact of an Aging Population," in Alice M. Rivlin and Isabel Sawhill, editors, *Restoring Fiscal Sanity: How to Balance the Budget*, Brookings, 2004, table 5-1, p. 68

[12] Peter A. Diamond and Peter R. Orszag, *Saving Social Security: A Balanced Approach*, Brookings, 2004; Henry J. Aaron and Robert R. Reischauer, *Countdown to Reform: The Great Social Security Debate*, Century Foundation 2001.

Against this background, it is fair to enquire whether making the tax cuts permanent is the best possible use of the funds that higher rates would generate. The long-term cost of the tax cuts enacted in 2001 and 2003 is three times the cost of closing the seventy-five-year deficit in Social Security and more than sufficient to close not only that deficit but also that in Medicare Hospital Insurance. Given the choice, the American public might well prefer to devote at least some part of the revenues that will be generated as the tax cuts expire to reforming and restoring balance in Social Security and Medicare. *In addition, it is quite odd that an administration which has emphasized the importance of taking account of the size of the multi-trillion dollar long-term shortfall in Social Security and Medicare fails take account of the even larger multi-trillion dollar long-term cost from making tax cuts permanent*.

The demands on the public sector over the coming decades confront the United States with a challenge that few democracies have been able to handle. Congress and the American public will be forced to choose among three broad options:

P The first is to raise total tax collections by 40-50 percent from the current level of just under 16 percent of gross domestic product to roughly 25–28 percent of gross domestic product.

P The second is to slash pension and health benefits for the rapidly growing numbers of elderly and disabled and to withdraw the safety net under the poor. Please note that privatizing these services offers no fiscal relief whatsoever. Either benefits must be cut or dedicated revenues must be increased; those are the only options.

P The third is to run huge deficits that would quickly destroy the willingness of financial markets to lend to us and amount to economic suicide for this nation.

None of these choices is palatable, but there are no others. The nation is likely not to rely on any single one of these options. If it behaves responsibly, however, it will not use the third, but will choose some combination of tax increases and reductions in pension or health benefits and not rely at all on the third option. I am not here today to embrace any particular approach, but rather to point out that the stress of choosing among what may now seem unthinkable alternatives will be enormous and that poor choices will threaten the nation's economic stability. Cutting deficits now will ease those problems later. Cutting taxes and raising deficits as the Administration's announced policies will do will only intensify the problems.

It is tempting to try to wave off such unpleasant projections, for example by pointing to the well-documented inaccuracy of forecasts. But the current deficit problem is not a forecast, but a reality. The imminent retirement of the baby-boom generation is rapidly becoming a reality. This nation is rich enough and its institutions are flexible enough to cope with both problems, but not by ignoring them, not with currently legislated taxes, and certainly not by cutting taxes still more.

V. A CURRENT ACTION PROGRAM: DOES THE ADMINISTRATION PROGRAM MEET THE TEST?

Against this background, does the Administration's program as set forth in its 2005 budget begin to meet the challenge? The answer, alas, is that it does not. The budget claims that it will reduce the budget deficit, projected to be $521 billion in 2004, to $237 billion in 2009, a reduction of more than half. There are several problems with both the target and with the claimed achievement toward it.

When is a Cut not a Cut? The heralded halving of the budget deficit is actually an increase in the deficit relative to what the Administration projects will happen if it doesn't do anything other than fund current services. Table S-14 (p. 388) of the budget reports that the unified budget deficit will fall from $527 billion in 2004 to $211 billion in 2009. *Thus, the budget's actual commitment to reach $239 billion amounts to a $28 billion increase in the deficit*.

Furthermore, the choice of 2005 through 2009 as the period over which to measure progress toward deficit reduction is grossly misleading. The first baby-boomers become eligible for Social Security in 2008 and for Medicare in 2011. Extension of the expiring tax provisions of the 2001 and 2003 tax acts that the Administration seeks to make permanent will affect revenues only in years following 2010. *Thus, the Administration claims credit for deficit reduction, while actually increasing it, over a period—2005–2009—conveniently before its own deficit-increasing policies take effect and before the commitments of past legislation inexorably drive up projected budget deficits*.

The Program. The Administration is on record with commitments that make achievement of even this remarkably unambitious objective highly improbable.

! The Administration has indicated that it will propose relief from the alternative minimum tax in 2005. Just how much such relief will lower revenues depends on how much relief is given. Sufficient relief to hold constant the number of filers subject to the AMT could lower revenues as much as $200 billion cumulatively from 2005 through 2009 and more than $600 billion over the succeeding five years. *The absence of any specific minimum tax relief from the 2005 budget means either that tens of millions of filers will not receive the tax cuts that the Administration proposes to make permanent or that the tax collections will be lower and the deficit larger by the amount of such relief.* ***The Administration cannot have it both ways.***

! Even the deficit reduction that is promised is partly phony. The Administration has asked once again for a variety of new saving "incentives." Within the five-year projection period they are scored as revenue increases, but they would reduce revenues by hundreds of billions of dollars in later years because all investment earnings and withdrawals would be exempt.

- Nor despite promises dating back to the 2000 campaign to restore balance to Social Security does the budget contains any specific proposal to reform Social Security. The budget does put in a good word for the recommendations of the president's own Social Security commission. Unfortunately, all the commission's three plans would aggravate the budget problem, adding approximately $4 trillion each to the public debt by 2040, according to official estimates the Commission reports.

A Better Way. In confronting a deficit problem of the size American faces, the first requirement of good policy is honesty—about the size of the problem and of the steps that it will take to deal with it. Staff of the Brookings Institution tried to meet that challenge in its recent report, *Restoring Fiscal Sanity: How to Balance the Budget*.[13] It starts by presenting an honest measure of the unified budget deficit over the decade from 2005 through 2014. Next, it explains why closing that deficit is a vital first step to dealing with the nation's long-term fiscal challenge. Finally, it lays out three programs to achieve that objective.[14]

- One of the programs relies primarily on spending cuts to close the deficit. It is a program designed to represent how an advocate of small government could simultaneously pursue that objective and fiscal balance.

Although this option entails expenditure cuts that many would regard as draconian—elimination of all federal spending for elementary and secondary education, housing and urban development, manpower training and related programs, environmental protection, and law enforcement, for example, as well as many other cuts—spending reductions are insufficient to restore fiscal balance by 2014. It is still necessary to boost taxes by $134 billion a year, relative to a baseline in which all of the 2001 and 2003 tax cuts are extended.

- Another program expands government spending and raises taxes enough not only to pay for that spending but also to close the deficit. It is a program that implements an activist *and* fiscally responsible vision of government.

- An intermediate program, which most of the authors of the study embrace, would restore fiscal balance with a combination of spending cuts and tax increases.

This study demonstrates that one need not plunge the nation into a fiscal morass in pursuit of any particular vision of government. It also underscores that it will take courage and patience to restore fiscal sanity to a policy trajectory that is badly astray. The Administration's proposed 2005 budget does not meet any of these tests.

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13 http://www.brook.edu/es/research/projects/budget/fiscalsanity.htm

14 The report stresses that closing the deficit on the budget excluding retirement programs is the proper goal, but acknowledges that it is so large that closing it completely over the next decade is probably beyond the political will of the nation.

VI. PROPOSED CHANGES IN BUDGET PROCEDURES

Many observers warned that the expiration of the Budget Enforcement Act would remove a useful device for constraining spending and tax cuts. They have urged Congress to adopt new procedures that would promote fiscal prudence. The 2005 Budget contains proposals to alter the budget process. Unfortunately, they would be neither effective nor fair and Congress should adopt quite different rules.

The Administration proposes that Congress adopt rules under which any legislated increase in entitlement spending or refundable tax credits would have to be offset by cuts in other entitlement spending or other refundable credits. No restriction would apply to cuts in positive taxes. This rule contrasts with the old pay-go rules under which entitlement spending and tax changes of all kinds were grouped.

The proposed rule is not worthy of serious consideration, in my view. It is hard to conceive a rationale that would place greater procedural burdens upon spending and tax credits that primarily benefit the elderly, disabled, and households with low or moderate incomes—the primary beneficiaries of entitlements—while creating no obstacle to deficit-increasing cuts in positive income taxes paid primarily by upper-income households. As Alan Greenspan has stressed, one must deal both with tax and spending entitlements.[15] By embracing such budget procedures, the Administration has surrendered any right to accuse opponents of its policies of class warfare.

Under the Administration's proposed budget rules, any increase in discretionary spending above the Administration's baseline would require a super-majority. Some target is surely necessary. But the one that the Administration proposes is not reasonable. It proposes as a baseline to hold non-defense discretionary spending constant in *nominal* dollars between 2004 and 2009. This target amounts to a drop in real per capita spending of approximately 15 percent over this five year period. Nondefense discretionary spending would fall from 4 percent of GDP in 2005 to 3.2 percent of GDP in 2009, lower than any other year published in OMB's *Historical Tables*. If this trend reflected the demonstrated intent of either the Administration or Congress, it might make

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15 In testimony before the entitlement commission Mr. Greenspan had the following exchange with Rep. Eva Clayton, Democrat of North Carolina:

REP. EVA CLAYTON (D-NC): ... This particular commission is, think, in part, given the challenge to look at entitlement in terms of those entitlements of expenditure. Would you not say that there are also entitlements in terms of tax provisions that are given, and that both of those in their combination is how we begin to look at the productivity of our country as we move towards getting a handle on that, both the revenue side as well as the expenditure side?

MR. GREENSPAN: Well, we addressed a number of these items in the 1986-87 Tax Act, where a substantial amount of the deductions were eliminated. But I don't deny, *I think you're absolutely correct, that if one is looking at the deficit and where elements of removing subsidies, removing various different types, if you want to put it, tax entitlements are concerned, I think you have to look at both sides.* (Emphasis supplied) sense, but it does not. The Administration has proposed and Congress has approved gradual increases in non-defense discretionary spending. There is no indication that either wants to reduce per capita services by one-fifth. *The implausibility of this projection is yet another reason why the Administration's claims of reducing the federal deficit are not to be taken seriously*.